TO: Senate Committee on Finance
Hurricane Katrina: Community Rebuilding Needs and Effectiveness of Past Proposals
September 28, 2005

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The Low-Income Housing Tax Credit and the Hurricane Katrina Relief Effort

***Comments of the Affordable Housing Tax Credit Coalition*[1]**

September 28, 2005

According to The Washington Post, "Hurricane Katrina displaced more Americans from their homes than any event in at least 60 years." Furthermore, "efforts to find housing for 200,000 families from the devastated Gulf Coast are getting bogged down, according to federal, state, and private sector officials."[2] When Senate Finance Committee Chairman Charles E. Grassley announced this hearing, he stated that the Committee would be looking for "the most effective and efficient use of the taxpayer's dollar" to address rebuilding efforts in the Gulf Coast, such as those aimed at providing permanent housing.

The mechanism currently exists in the Internal Revenue Code to address the unprecedented and historic housing needs of the evacuated residents of the Gulf Coast states. The Low-Income Housing Tax Credit ("LIHTC") program is the most significant Federal financial resource for the production of affordable rental housing for America's low-income families. It is tested, efficient, transparent, and both self-policed and policed by federal and state agencies. The program helps catalyze public/private/community partnerships that create safe, affordable, attractive housing; brings private capital, and primes the market for other activities, including home ownership and retail facilities.

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[1] The Coalition is a trade organization based in Washington, DC comprised of most of the major private sector participants in the Low-Income Housing Tax Credit program. Its members are syndicators, institutional investors, for-profit and not-for-profit multifamily developers, lenders, and public agencies (including those which allocate Low-Income Housing Tax Credits). Coalition members are responsible for the vast majority of the six billion dollars invested annually in affordable rental housing properties.

[2] See The Washington Post, "Housing the Displaced is Rife with Delays," September 23, 2005.

However, to address the housing needs of upwards of 200,000 families displaced by Katrina, the LIHTC program must be significantly enhanced on a short term and targeted basis.

The Affordable Housing Tax Credit Coalition, therefore, is proposing that Congress:

- Provide substantial additional Housing Credit authority to the affected states for use in the affected areas. For example, under current law, Louisiana was allocated Housing Credit authority in 2004 to build 1000 affordable housing units. Because it is necessary to replace the many public housing projects and other housing for low-income individuals that was destroyed and the cost of supplies and labor is likely to increase, the Housing Credit authority necessary to finance a substantial portion of the units destroyed by Katrina will require an increase of a minimum of 100 times the current Housing Credit Authority;

- Coupled with our first proposal, allow for increased allocations for each property in areas impacted by Hurricane Katrina by increasing the eligible basis on which the Credit amounts are calculated. The additional credit allocation would be determined by the state Housing Credit agency in an amount necessary to develop such buildings quickly, even where additional sources of financing are not immediately available and at rents that are affordable to low-income families whose jobs and lives have been affected by this catastrophe;

- Repeal, for buildings located in areas impacted by Hurricane Katrina, the provision that prohibits the use of 9 percent credits with below market federal funds so as to allow federal funds to more efficiently leverage tax credit equity investment (this would not be applied with respect to tax-exempt bond financed buildings); and

- Provide the Secretary of Treasury with the explicit authority to promulgate regulations temporarily waiving income limitations under Section 142(d) so that the rules for bond-financed properties conform to the rules recently issued by Treasury for Housing Credit properties. Treasury officials state this legislative authority is necessary to allow the Department to issue regulations so that displaced Hurricane Katrina victims, regardless of financial status, can be placed in tax-exempt bond financed housing without tax penalty to property owners.

Background of the Housing Credit

Originally signed into law as part of the Tax Reform Act of 1986, the Housing Credit is responsible for the production of to up to 50 percent of all multifamily housing starts in any given year, and virtually all affordable rental housing in the United States since that time—over 130,000 dwelling units annually and more than 1.7 million units since enactment. The program is also responsible for an estimated 167,000 jobs each year associated with the creation of housing.

The Congress understood from the beginning that private capital could only be attracted to affordable housing if there were tax benefits to replace the cash flow typically paid to real estate investors. The program is a model of effective use of public resources, leveraging taxpayer dollars with private capital, creating well-aligned public-private partnerships, and relying on states for administration and local priority setting.

Together, these factors assure that any new housing developed meets local community needs and is developed and maintained in accordance with strict compliance rules. In 1993 Congress decided to make the Housing Credit a permanent program. Its longevity is testimony to the fact that the program has operated as intended. The program enjoys widespread and bipartisan congressional support—in 2000, legislation to increase the amount of Housing Credits was co-sponsored by 85 percent of the Congress, with almost equal numbers of Republicans and Democrats.

In May 2005, recognizing the success of the program and the need for more safe, affordable housing, Congressmen William Jefferson (D-LA) and Phil English (R-PA) were lead co-sponsors on a bill to double the Housing Credit authority nationwide. They were joined by 60 members of Congress, including 10 members of the Ways and Means Committee. At the time that Cong. Jefferson and Cong. English introduced their legislation, no one could have predicted that Katrina would destroy over 200,000 units of housing. Now that housing needs in the Gulf States are so acute, legislation will be needed to increase the tax credit authority available to the Gulf States by at least 100 times the level of current authority available to those States.

How the Housing Credit Works

The program provides tax incentives, in the form of credits against federal income tax, in exchange for investment in newly constructed or substantially rehabilitated affordable rental housing. For periods of 30 years or more, this housing must serve low to moderate income tenants, who pay restricted rents and who earn a maximum of 60% of area median income (although average incomes in these properties are often far lower). Credits are allocated to the several States based upon their respective population. The States determine their own housing priorities, within broad federal guidelines, and then choose which proposed developments will receive Housing Credits.

Developers, many of which are non profit organizations, must compete for Housing Credit allocations under a highly transparent selection process In most States, demand for Housing Credits far exceeds the supply, even with the increase authorized in 2000. Developments which are awarded Housing Credits are located in urban, suburban and rural areas. Although a majority of the properties serve families, a substantial number serve elderly, disabled and special needs populations.

Once the Housing Credits are awarded to a housing developer, investors provide equity capital to finance a substantial portion of the costs of constructing or rehabilitating the housing. This equity capital reduces the need for mortgage financing and decreases debt service payments, thereby lowering operating costs and allowing owners to rent to low-income persons who pay rents they can afford.

Approximately 98 percent of this equity capital is raised from corporations, including banks, financial institutions, insurance companies, and Government Sponsored

Enterprises. Investors have invested nearly fifty billion dollars since 1986. Many banks invest in the Housing Credit as a means to fulfill their Community Reinvestment Act requirements. Prices began to rise after the Congress made the Housing Credit program a permanent part of the Code in 1993 because investors became confident that the program would exist for the long term. Indeed, prices paid by investors for credits, which funds are used to build this housing, have risen by approximately 50 percent in the past ten years, meaning that each tax credit dollar brings in more private capital, increasing the program's efficiency.

Housing Credits are earned over a 10-year period, although they are subject to recapture for 15 years if various program rules are violated. This sets up a self-policing system. Corporations are highly motivated to make sure that the Housing Credits are received and not lost to recapture. Many corporations engage firms with special expertise in this area, often referred to as Housing Credit syndicators, to help them in structuring and monitoring the properties. This very intense oversight and the effective administration conducted by States are the principal reasons that the program has operated in accordance with government requirements—and even exceeded expectations—throughout its history. The threat of the severe penalty of tax credit recapture serves to keep the program operating as Congress intended.

The Housing Credit Provides Economic Stimulus

Members of the Louisiana Delegation have stated that their number one goal is to get the citizens of Louisiana, and especially New Orleans, back home. Building housing, creating jobs, and resuming commerce are crucial steps towards meeting this goal. The Congressionally-appointed, bipartisan Millennial Housing Commission stated last year that the evidence is "mounting that stable, affordable rental housing plays an important role in helping families find and hold jobs." Quality affordable housing could be a crucial factor in convincing people to return to the areas devastated by the Hurricane and to stay once they have returned.

The construction of LIHTC properties also creates jobs and stimulates the economy. Based on figures extrapolated from a study conducted by the National Association of Home Builders, each year the construction and ongoing operation of Housing Credit properties generates approximately $8.8 billion of income for the economy, creates 167,000 jobs, and produces $1.35 billion of revenue for cash strapped local governments. (It is estimated that building 100 units of multifamily housing generates 112 local jobs during the first year of construction and 46 jobs are sustained every year thereafter.) This is a much needed boost for the devastated areas of the Gulf Coast.

Why Use Tax Incentives?

Affordable housing development simply cannot be financed without the private capital attracted by the credit. HUD subsidies and other programs do not provide sufficient resources to encourage the development of affordable housing. For example, housing vouchers would not provide upfront assistance to build housing developments, nor would they address issues of rehabilitating old housing. New Orleans has a significant tourism business that will make the issue of rehabilitating old housing an extremely important one. Furthermore, the States do not have the resources to provide something on the scale of the Housing Credit.

The Housing Credit has always been a driver in the revitalization of lower income communities. Through the Housing Credit, private capital is used to reverse the cycle of decline. The Housing Credit has turned around neighborhoods and stabilized the urban core. The Housing Credit also contributes to recapitalization of existing housing and can be used to address special needs housing, such as housing for the elderly, formerly homeless, and special needs populations.

For all of these reasons, the LIHTC program should play a significant role in the Gulf rebuilding effort. As stated above, this means that the current Housing Credit authority allocated to the Gulf States will have to be increased on a targeted and temporary basis in the neighborhood of 100 times the current Housing Credit authority available to those States. That will carry a large tax revenue cost. However, using the test announced by Chairman Grassley to guide the Committee's review of various tax proposals designed to address the Katrina rebuilding effort, an enhanced and targeted LIHTC program will be "the most effective and efficient use of the taxpayer's dollar."